

A Toolkit on  
Illicit Financial  
Flows:  
Module 1

# Politics of Defining Illicit Financial Flows



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Southern Regions Program

**About the project:**

As a unique space under the Financial Transparency Coalition (FTC), the Southern Regions Programme (SRP) plays a crucial role of an incubator by placing just tax systems and financial transparency at the heart of development debates. In October 2017, during a South-South strategy meeting it was recognised to bring out a collaborative document that emerged from the perspective of the Global South. Five members<sup>1</sup> of the SRP came together to author the IFF Toolkit in an effort to address issues of financial secrecy, enablers of illicit financial flows, lopsided impact on domestic resources and the ability to raise further resources due to loss of revenue as IFFs and the much-needed reforms in the international financial architecture set in the context of Global South. The toolkit uses case study-based evidence to simplify the issue of tax abuse. The document also covers tax incentive abuse as a subject under IFFs. The toolkit has benefitted from discussions held at the Nepal Social Forum (March 8th-10th, 2018), Paper on Illicit Financial Flows: Rights, Restoring Justice and Freedom and Pan-Continental Southern Dialogue on Illicit Financial Flows<sup>2</sup>, Nairobi (November 21-22, 2018).

**Disclaimer:**

The publication has been produced by Centre for Budget and Governance Accountability (CBGA), Latin American Network on Economic and Social Justice (LATINDADD) and Tax Justice Network Africa (TJNA) who together form a part of the Southern Regions Program in the Financial Transparency Coalition (FTC). This output does not intend to reflect the positions of all members of FTC.

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<sup>2</sup> See more here - <https://financialtransparency.org/ftcs-pan-continental-southern-dialogue-illicit-financial-flows-nairobi-21st-22nd/>

## A Toolkit on Illicit Financial Flows: Module 1

# Politics of Defining Illicit Financial Flows



# List of Acronyms

ACBF	_____	African Capacity Building Foundation
AFRODAD	_____	African Forum and Network on Debt and Development
AU	_____	African Union
AUC	_____	African Union Commission
CoDA	_____	Coalition for Dialogue on Africa
ECA	_____	Economic Commission for Africa
ECLAC	_____	Economic Commission for Latin America and the Caribbean
FfD	_____	Financing for Development
HLP	_____	High-Level Panel
IFCF	_____	Illicit Financial Cumulative Flow
IFFs	_____	Illicit financial flows
MNCs	_____	Multinational corporations
SDG	_____	Sustainable Development Goals
UNECA	_____	United Nations Economic Commission of Africa

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# Inside Out

## Countries lose huge sums of revenue as illicit financial flows. But what are they?

**t**o understand this phenomenon, we look into how trade routes were established during the colonial period via ‘tax havens’ giving rise to the present economic system. Used to hide one’s wealth, ‘tax havens’ have evolved as offshore/ onshore hubs of secrecy for businesses, oligarchs and the corrupt. Apart from offering low or no taxes to corporations, ‘tax havens’ also provide a shelter from other necessary rules and regulations set in place by oversight bodies. Naturally, these jurisdictions or hubs are central in facilitating illicit financial flows or IFFs.

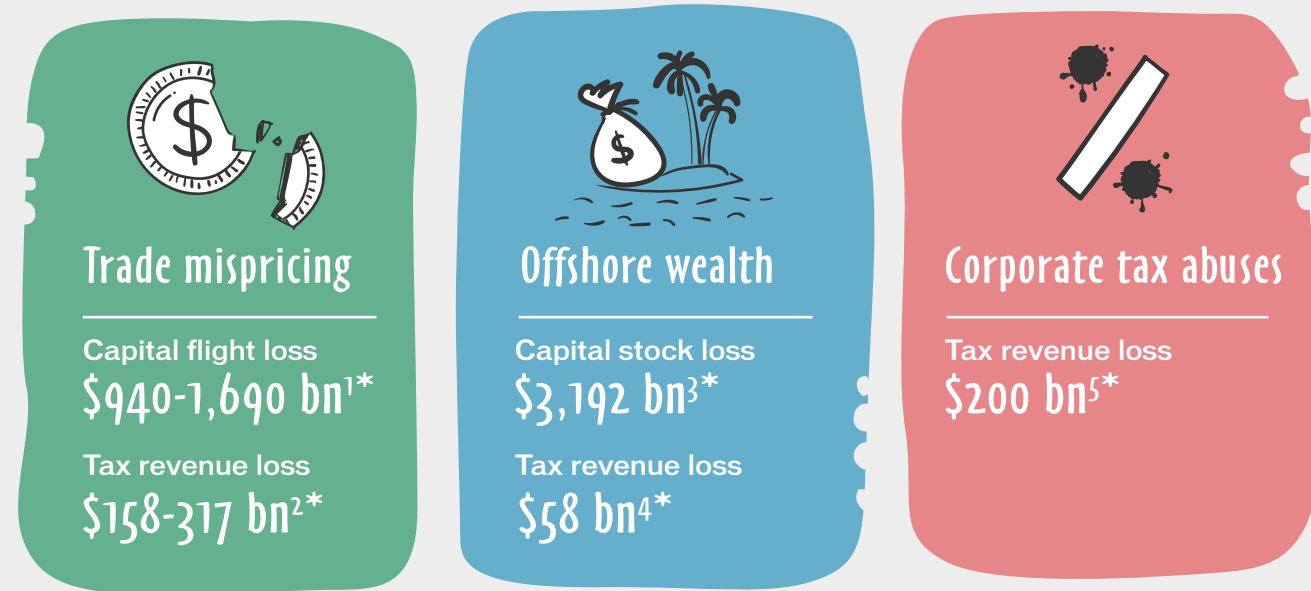
The entire concept of IFFs emerged as ‘capital

flight’ in response to the deregulation waves and the debt crises in developing countries in the 1980s after the oil shocks sent interest rates soaring, hitting the currencies and economies of the Global South. The discussion at the time was mostly had in institutions based in the Global North, who saw capital flight<sup>1</sup> as a result of the loss of investment climate and economic confidence of residents of the country. It was assumed that unrecorded capital flight or mispriced trade was mainly due to differences in methods of recording balance of payments<sup>2</sup> or trade transactions.

In fact, the first instance of framing capital flight as ‘illicit’ was discussed by Bhagwati (1964) and then in 1974 by Bhagwati, Krueger, Wiluswadia where illegal capital flight was defined as the undocumented capital transacted either by deliberately under-invoicing exports and/or over-invoicing imports, or faking of trade documents



# Table 1 Illicit Financial Flows related capital losses and revenue losses



Notes:

- 1\* Global Financial Integrity, January 2019, low-end estimate is trade mispricing using IMF DOTS-based estimate, while high-end estimate is the UNCTAD COMTRADE-based estimate.
- 2\* Global Financial Integrity, June 2019a; Global Financial Integrity, June 2019b; Global Financial Integrity, June 2019c, these three studies of tax losses arising from trade mispricing give a range of 16.9% in Egypt to 17.6% in India and 18.8% in Indonesia. We use the lowest estimate and IMF DOTS low-end trade mispricing estimate for \$158 billion, while highest 17.7% and high-end COMTRADE-based method for \$317 billion.
- 3\* Zucman (2017), here we have the total wealth offshore figure of \$8,700 billion, of which we exclude high-income countries according to the 2019 World Bank classification to arrive at \$3,192 billion for countries in the Global South.
- 4\* Zucman, Alstadsæter and Johannesen (2019) for method of calculating revenue loss from the offshore stock of capital, using data from Zucman et al we disaggregate the share of countries in the Global South to include 52% of Asian offshore wealth (excluding high-income Asian countries), all of Latin American and Caribbean countries, all of African countries and Russia as it is in 2019 classified by the World Bank an upper middle-income country
- 5\* IMF (2015)

as a consequence of exchange controls in the Global South. From then a literature on illegal and illicit capital flight emerged, which pointed out corruption and tax evasion as motives for capital flight—in trying to figure how much of this capital flight was in fact criminal or abusive activity, and what proportion was in some way legitimate. The seminal study that showed the vast majority of capital flight was illegitimate in a number of cases was the paper by Boyce and Ndikumana (2001). They linked a number of debt crises to a dynamic where the corrupt elites stole the money raised in the form of debt into personal gain, thus causing illegal capital flight.

Initially Boyce and Ndikumana looked only at capital account movements that were unrecorded, with the assumption that if something is not recorded it is likely to be due to the illicit nature of the transaction. Subsequently, with trade data being analysed, it was added that trade mispricing should also be considered an illicit financial flow if there are mismatches. Building on their work, Baker (2003, 2005) coined ‘dirty money’ for capital that is illicit in its origin, transit or destination. This, later on,

has become the narrowly conceived definition of Illicit Financial Flows mainly focusing on ‘illegality’ of financial flows (Kar and Cartwright-Smith, 2006). The legalistic conception minimises the larger systemic aspects of the problem. Therefore, it is also important to include tax-related flows like profit-shifting and tax abuse (tax avoidance, tax dodging and tax evasion) under the ambit of IFFs.

The term illicit financial flows became an intergovernmental issue with the convening of the 4<sup>th</sup> Joint AU Commission / UN Economic Commission for Africa (AUC/ECA) Conference of African Ministers of Finance, Planning and Economic Development in 2011. With newer research<sup>1</sup>, the term includes capital income derived from undeclared offshore wealth held often in tax havens. We arrive at a matrix of data and case-study evidence that structure the understanding of illicit financial flows.

The next few sections address the different components of IFFs to arrive at a progressive definition through discussions on progress made in developing regions.






# Locating the Harm

By design, illicit financial flows disproportionately impact developing countries as they widen financing gaps and prevent any fair redistribution of resources. IFFs emerge from “financial activities and practices that are illegal or abusive”<sup>4</sup> and elusive in nature with a cross-border impact. This includes activities like tax abuse, use of exploitative bilateral or multilateral tax, trade and investment agreements, harmful tax incentives, abusive transfer pricing, odious debt, trade misinvoicing, crime, bribery, corruption among others— using national and international instruments, agreements and structures and corruptible legal and political domestic environments. Poorly planned policies and agreements while may be adhering to the law still provide a basis for abusive practices. When unpacking domestic environments backed by governments, Arun Kumar (1999) describes the predominant role of systemic drivers. Policymakers, businesses and the executive together form a working triad of political class that generate illicit money. Over the years, massive investigative revelations like the Swiss leaks, Panama Papers, Mauritius leaks etc. have brought public attention on their role as facilitators of IFFs.

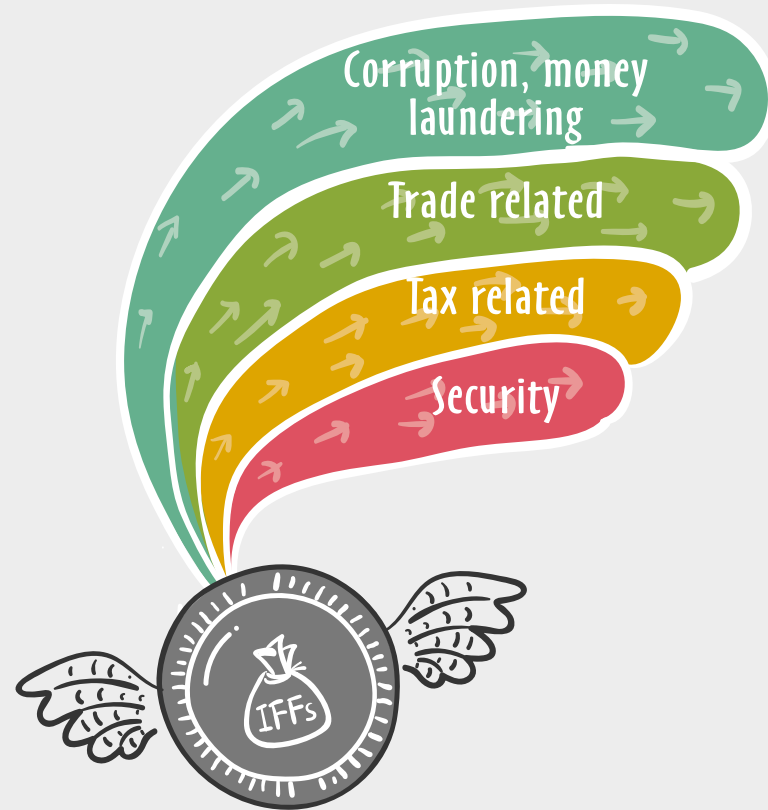
Secrecy keeps these funds out of the public



and state eye by continuously eroding accountability. Disguised in licit circles of finance, more often than not, abusive practices do not get investigated timely due to the lack of administrative or immediate technical and fiscal resources available, especially in developing countries. Thus, contributing to the normative and theoretical debate of how IFFs have concrete socio-economic as well as judicial and political consequences especially for the South. This has led to a stronger support towards progressive definition of IFFs and its accompanying metrics.

## Different Definitions and Aspects – Missing Elements

As a systemic issue, its definition and the need to unpack underlying causes are both a technical and a geopolitical debate. The standards of the international financial architecture are set by international bodies and institutions based in the Global North, which also bears effects on the sovereign rights of a developing country. These institutions aim to address different aspects of IFFs. While private firms and developed countries are members of these institutions many developing countries are not<sup>5</sup>. Further, most official definitions of illicit financial flows are broad. Different actors emphasize



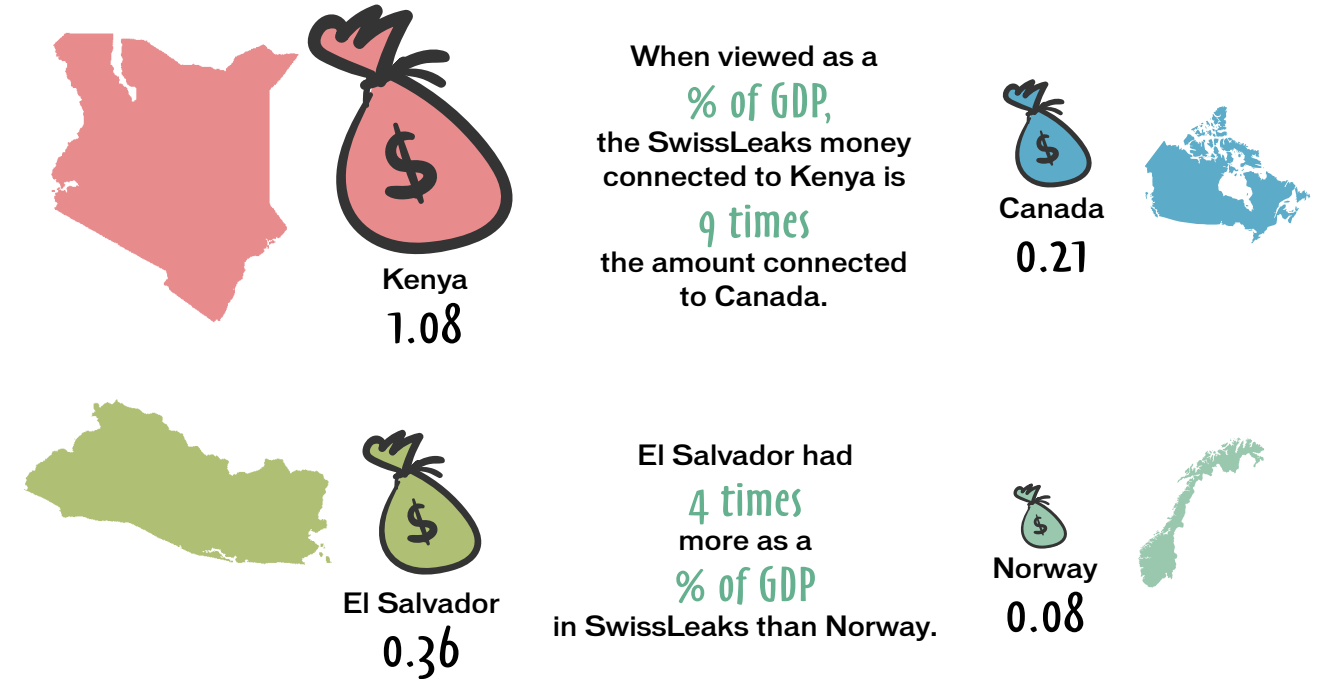
different issues of IFFs. Hegemonic powers and security-oriented UN agencies<sup>6</sup> for example, tend to focus on terrorist financing and stolen assets, while development and human-rights oriented UN agencies highlight the impact of transnational corporations' tax dodging practices and capital flight. But civil society advocacy and recent research studies, particularly after the global financial crisis, have brought IFFs to the mainstream. Although, the debate is still dominated by Northern based institutions.

A prime characteristic of IFFs in all working definitions is the cross-border or international dimension. While few methods have tried to focus on the finances of strictly criminal activities such as drug trafficking, others do not provide estimates for "flows", but rather for stocks of wealth—especially that are hidden in resident banks of offshore jurisdictions. It is the operationalisation of the concept that serves as a feedback for the definition itself. The need to examine the role of intermediaries, destination locations, looking for policy alternatives and the need to go beyond the legalistic definition are crucial.

## Global progress on IFFs — Why is the fight geopolitical?

The transition from illegal to illicit has been a

## Dollars held in HSBC Swiss as a % of GDP



Source: Financial Transparency Coalition and Christian Aid (2015). Swiss Leaks Reviewed.

tough journey that is yet to be fulfilled. The use of the term 'illicit' in the definition reveals a moral or ethical lapse that needs to be addressed. Despite the issue of IFFs being on the global radar for more than 10 years, the international community has yet to agree on its definition. This lack of consensus on the definition is

recognised as the most fundamental gap in being able to address the issue effectively<sup>7</sup>. Consequently, the roadblock on being able to achieve a consensus has limited the discussion to drive a binary narrative of legal vs. illegal and it is this lack of clarity on the terminology that prevents sound policymaking. For example, the

Financing for Development (FfD) negotiations too have witnessed a major opposition towards including trade misinvoicing under IFFs. Issues like debt have still not received their due consideration under IFFs. Even in the most democratic and legitimate institutions—like the United Nations General Assembly, a broad and purposefully ambiguous political consensus was attained on the issue. Nonetheless, the inclusion of the IFFs target in the UN 2030 SDG Agenda was a welcome result.

The UN Statistical Commission has identified the SDG indicator 16.4.1 on IFFs as -

*“Total value of inward and outward IFFs (in current US dollars)” as the global metric to monitor 16.4 target of the SDGs (i.e., “By 2030, significantly reduce illicit financial and arms flows, strengthen the recovery and return of stolen assets and combat all forms of organized crime”), together with the indicator 16.4.2 on illicit firearms trafficking (i.e., “Proportion of seized and small arms and light weapons that are recorded and traced, in accordance with international standards and legal instruments”).*

The corresponding metric for the SDG target 16.4 is purposely broad in response to the conceptual definition agreed upon politically, where the more explicit terms in the definition

lean towards the “global security” agenda of the hegemonic powers of the North. Mention of “arms”, “organized crime”, and “stolen assets” within the illicit flows and the lack of mention of tax matters are a direct demonstration of geopolitical priorities and intentions of these hegemonic powers. It is thus a challenge for countries of the South to tackle tax-related issues within the present conceptual framework<sup>8</sup>.

The SDG target 16.4 itself is broad enough, and it is reminiscent of tax-related civil society led discussions around “inflows and outflows”. An outflows-only metric would have been biased in favour of the Global South’s agenda, more indicative of capital flight and capital extractivism<sup>9</sup>. By including “inflows and outflows”, a counterproductive interpretation (from the South’s perspective) could imply that outflows are netted with inflows, and thus, the net impact of illicit financial flows is minimised. The “total” amount of inward and outward IFFs can be interpreted to mean “total net”, in which case the result for the whole world (global inwards - global outwards) would be zero. Therefore, it is crucial from the perspective of the South to insist on gross estimates, for both inflows and outflows (and give less importance to the net amounts). It is also an opportunity to reflect on the fact that the South’s aggregate outflows imply (by accounting identities) the North’s aggregate

inflows. This is a very important concept because while it may be excruciatingly complex to quantify outflows originating from the South, it is much simpler to quantify inflows arriving in the North. This measurement consideration is not trivial, as it assigns responsibilities to the North as facilitators, enablers and gatekeepers of IFFs.

There are other tests that reveal the illicit nature of activities by identifying illicit motives such as “market and regulatory abuse or abuse of power”. Among Southern actors, the African Union Commission (AUC) and United Nations Economic Commission of Africa (UNECA) took the lead in setting a technical and a political agenda on curbing illicit financial flows in 2015 from Africa by including tax avoidance in their definition. This approach later also influenced the UN Economic Commission for Latin America and the Caribbean (ECLAC) in categorising tax avoidance. Going beyond the legal lens of viewing IFFs, the module situates this issue in the rights-based framework.

## The Broken Financial System: Role of the North

Money exists, overwhelmingly, in accounting records. Accounting exists, overwhelmingly, in digital form. Unlike physical bills, which are

also not trivial in IFFs and flow bilaterally, book (digital) money flows in a triangular way following the principle of double-entry bookkeeping. A debit in the sender and a credit for the receiver is mediated by a bank. If a transaction is in accounts of two different banks, a triangular five-entity bookkeeping exercise occurs in three separate ledgers. The first ledger records a debit in the sender’s account and in the sender’s bank’s account at the central bank. The second ledger records a credit in the receiver’s account and in the receiver’s bank’s account at the central bank. Occasionally, the third bank involved is not the central bank but another correspondent bank. If the transaction occurs internationally, other correspondent banks may be involved until a “payment chain” between the sender and receiving banks is established. Tax authorities, financial intelligence units and central banks should be overtly conscious of the fact that IFFs exist in accounting records<sup>11</sup>. If the corresponding risk profiles merits the case, these authorities should be able use modern information technologies to have access to banking and corporate ledgers in real-time, and with big data, artificial intelligence and network analysis, to improve their capacities to identify IFFs.

As the Kathmandu Declaration has identified, the

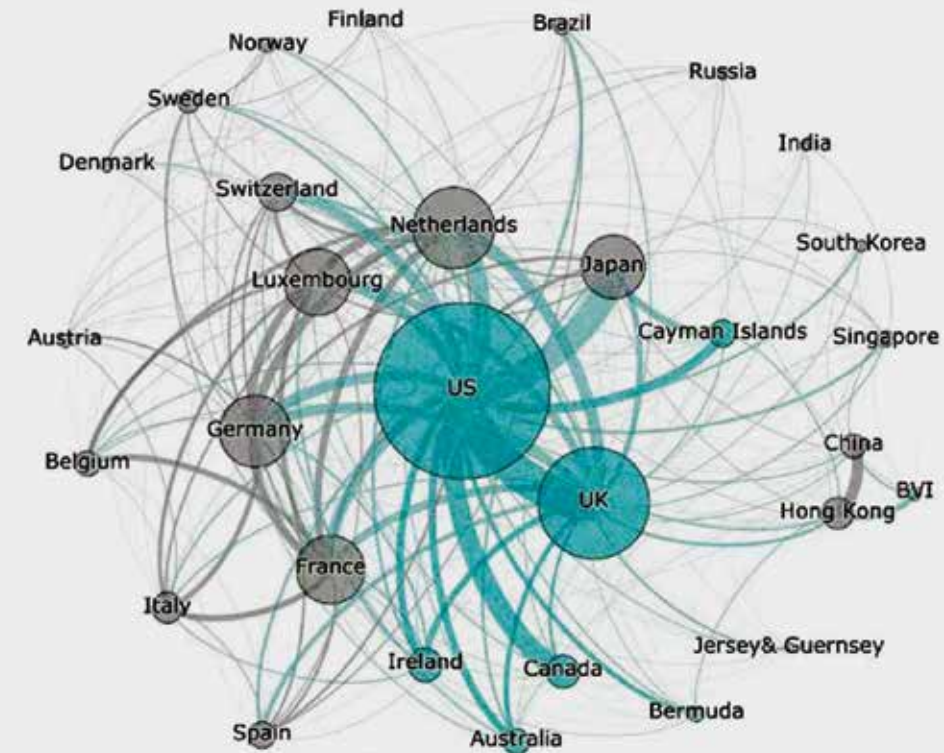


## Geopolitical Implications of using “US dollars” in SDG 16.4.1



The phrase “in current US dollars” itself reveals a prime characteristic of the nature of IFFs. One that they are primarily cross-border and international in nature<sup>10</sup>. Two, IFFs are not usually channelled in domestic currencies and particularly not in currencies of countries of the South. This highlights the role of central banks, together with tax authorities in recording, preventing and combatting them. Therefore, a conversion of IFFs to US dollars or other “hard” currencies, such as Euros or Sterling Pounds is a necessary step. The US dollar is not only the unit of account of the UN metric, it is also the unit of account of organised crime and international taxation. This includes physical bills as it is the most frequently used currency for international transactions and thus, offshore banks.

This apparently innocuous characteristic shows how IFFs are not exclusively the responsibility of Southern countries because US dollar assets of IFF holders are, by identity, US dollar liabilities. These IFFs are recorded in the books of US banks which are ultimately connected to the US payment system. A major implication of this imbalance is that US has the power and the responsibility to inform the countries of the South of the existence and provide all details of IFFs.



## The Big Picture of Global Finance in 2012

Source: Jan Fichtner (2016). Perpetual decline or persistent dominance? Review of International Studies.

capacities of government agencies of the South on this matter are significantly lower than those of the North. Development assistance should not only grant artificial intelligence capabilities in kind and in training to governments of the South, but should also contribute to government regulators who are then able to access, replicate and adapt

transnational megabanks’ due-diligence and compliance technologies.

The overwhelming majority of IFFs are cross-border in nature, and the overwhelming majority of cross-border flows are channelled via the SWIFT’s messaging system<sup>12</sup>. SWIFT must

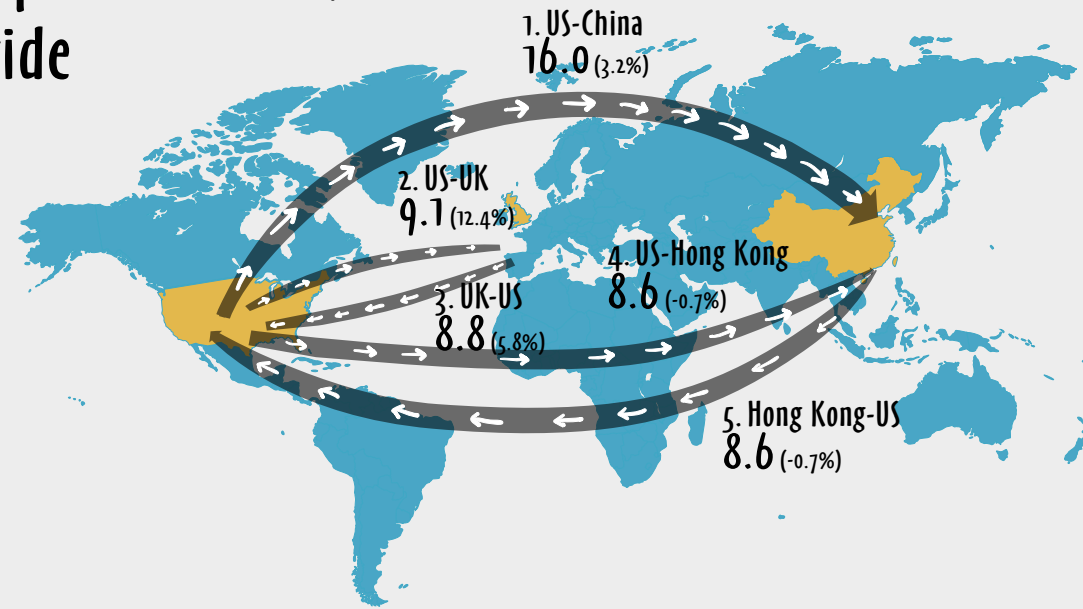
become an important partner in the statistical compilation of IFFs along the lines identified above. Money that does not flow in liquid form (is not settled in the banking system) but is rather registered as accounts payable in corporate accounting records should allow tax authorities to have access to corporate ledgers, as mentioned

above. The increasing role of private-bank owned SWIFT as a public utility should not be overlooked. The US Department of the Treasury, as per an EU Directive, has direct access to all of SWIFT’s data since 2001. While SWIFT is a Belgium-based organisation, Northern institutions such as the EU and the US do have



# Figure 1: Top 10 Corridors for Worldwide Payments

Live, delivered international MT 103s sent in YTD September 2018



Source: SWIFT, available at <https://www.swift.com/file/56941/download?token=MDb4vMos>

## National definitions:

Argentina's former (now defunct) state-led think tank CEFID-AR was the most proactive quasigovernmental entity concerned with IFFs. A series of papers led by Jorge Gaggero explored definitions of capital flight and illicit financial flows. This approach has been widely adopted in Argentinian economic research circles in the statistically feasible "formación de activos externos" or "foreign asset accumulation".

access to its information on regulatory grounds, but the countries of the South—or even the UN institutions—do not<sup>13</sup>.

One aspect of IFFs that may hide structural asymmetries between North and South is the temporary nature of flows. Flows are movements that happen within a time unit. The unit should specify if flows are measured as US dollars every quarter or in a year. It is important to note that the UN metric does not establish that IFFs as a yearly flow or a yearly average of a cumulative flow. The correct unit expression for financial flows should be "US dollars per year", not "current US dollars". This incorrect conceptual designation of the relevant unit opens up the discussion for a stock variable, one which does not require a time-unit denominator. However, flows and stocks are not the same. In fact, in practice,

many statisticians compile stock figures derived from cumulative flows. But flows do not exist in vacuum; they accumulate to form a stock figure, even if the stock figure is invisible. An illicit financial stock or "illicit financial cumulative flow" (IFCF) of the South's assets are liabilities of the North. According to Boyce and Ndikumana (2000), Africa's external assets (many originated via IFFs) are larger than its official foreign debt, and thus, Africa is a net creditor. An IFCF would imply that there is debt—as measured by the broadest definition of debt in the Quarterly External Debt Statistics (QEDS)<sup>14</sup>—owed by the economies of the North to the economies of the South. The loaded term "debt" carries with it an obligation—perhaps moral, in this case—of repaying that debt to the South, akin to international reparations. Or at least, of "netting"<sup>15</sup> the North's debt with the South's official foreign debt.



## Figure 2: Classification of Countries as Regional Hubs in the Core-Periphery Structure



Source: Cook S. and Kimmo Soramaki (2014). The Global Network of Payment Flows.

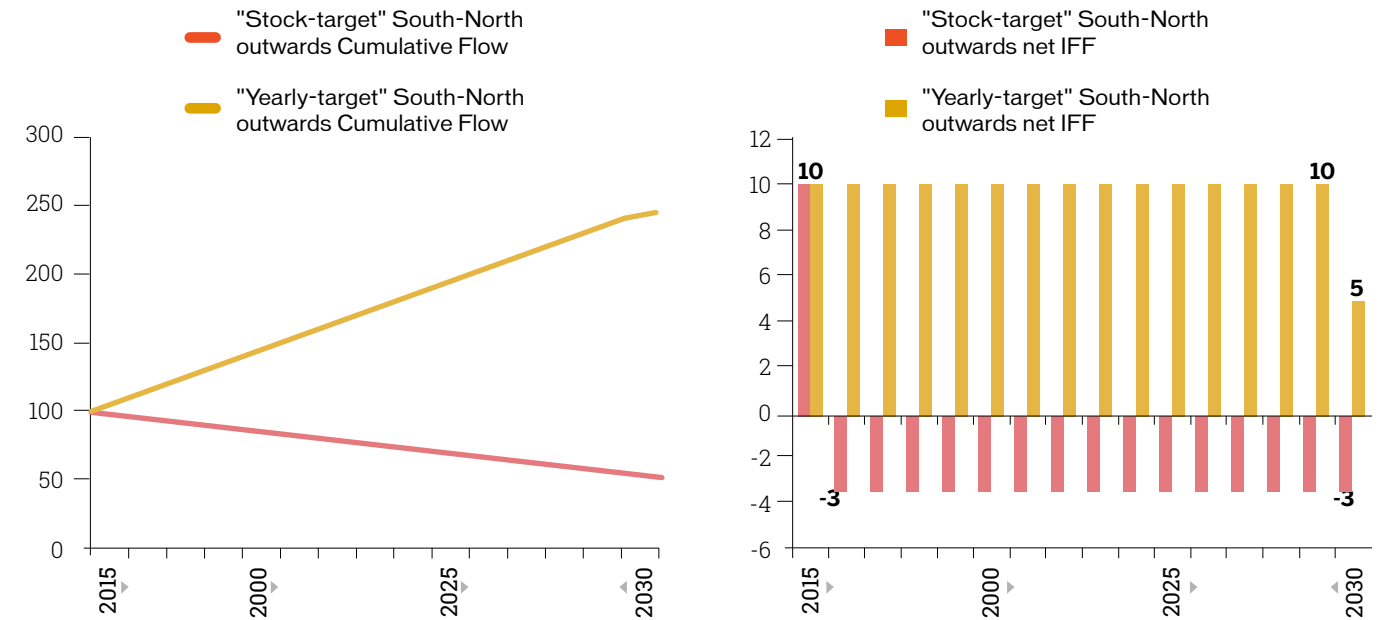
Available at: [https://swiftinstitute.org/wp-content/uploads/2014/09/SWIFT-Institute-Working-Paper-No.-2012-006-Network-Analysis-of-Global-Payment-Flows\\_v5-FINAL.pdf](https://swiftinstitute.org/wp-content/uploads/2014/09/SWIFT-Institute-Working-Paper-No.-2012-006-Network-Analysis-of-Global-Payment-Flows_v5-FINAL.pdf)

Note: July, 2013. Core periphery classification plus maximum spanning tree, 99% network. Core countries are in blue and the periphery countries are in yellow.

A target that aims for, say, halving the cumulative IFFs by 2030 would imply pro-active policies to return these assets to the South and have net negative South-North IFFs through 2030. A target that aims for halving the IFFs in the year 2030

would imply continuous flows to the North, but only at half the rate at which they were occurring, only in the year 2030 (i.e. no return). Using yearly flows only reduces the bleeding, it does not stop it. By using cumulative flows, we not only put a stop

## Figure 3: Simulation of the Target for Cumulative Flows vs Yearly Flows



Source: Based on Andres Arauz's calculations.

to the bleeding but actually recover the drained resources of countries of the Global South.

The elements discussed in this section are meant to raise several issues related to the interaction

between the conceptual definition of IFFs and the relevant metrics around it. From here we move to understand a unifying approach towards addressing the retrogressive impact on the realisation of rights.



# Why use a Human Rights Framework?

a human rights perspective provides an opportunity to move away from the ‘legal vs. illegal’ narrative trap which restricts definitive action. The rights-based approach places scrutiny on not only how businesses, investors, elites and their enablers operate but also provides ways to assess the impact and intent of an ‘activity’ based on existing human rights norms and standards.

**Thus, the module proposes to view IFF as a cross-border financial flow arising from an illegal or abusive transaction in terms of its nature, origin, transfer, use or destination.**

In March 2015, the interim study presented by the Independent Expert to the 28<sup>th</sup> session of the Human Rights Council highlighted the role of tax avoidance or minimisation practices signalling a major shift in how the issue has been framed so far. “(...) illicit financial flows encompass in addition to all kinds of artificial arrangements that have been put in place for the essential purpose of circumventing the law or its spirit, including certain legal ‘tax-optimization’ schemes, making use of legal loopholes that allow for example transnational corporations to shift around profits to zero or low corporate tax jurisdictions, without undertaking any real economic activities in those jurisdictions.” Connecting tax abuse to human

rights the Independent Expert argued that “tax abuse deprives Governments of resources required to progressively realize human rights, including economic, social and cultural rights, such as health, education, social protection, water, sanitation, as well as civil and political rights, including access to justice, free and fair elections, freedom of expression and personal security. Tax abuse can also undermine the rule of law, for example, when large-scale tax evasion is allowed to occur with impunity.” While listing recommendations for states, international bodies and non-state groups, the final study<sup>16</sup> linked tax abuse with principles of equality and non-discrimination.

There are primarily two approaches that inform such a framing—one follows a transparency and accountability lens and the other being a ‘violations’-based approach. This is crucial especially in light of no legally binding charters with human rights agenda solely aimed at tackling IFFs. If the fight against illicit financial flows is rooted in the language and dynamics of human rights<sup>17</sup>, including conventions like the International Covenant for Economic, Social and Cultural Rights, International Covenant on Civil and Political Rights, International Convention on the Elimination of all Forms of Racial Discrimination and their accountability mechanisms, it addresses the long-standing impediments and obstacles that are faced by human rights advocates and defenders seeking justice.



## Kathmandu Declaration's typology of IFFs

*"Illicit financial flows are generated from financial activities and practices that cause harm or that are illegal, and are abusive in their use of instruments and agreements in the international financial and economic system. These include issues such as tax abuse, abusive tax incentives, abusive use of bilateral or multilateral trade treaties, misuse of double tax treaties, odious debt, abusive use of mutual arbitration procedures, harmful tax practices, and unjust investment agreements, money laundering, trade misinvoicing, abusive transfer pricing, illicit money transfers, crime, bribery, illicit drug trade, corruption, and the 'offshore' trust industry."*

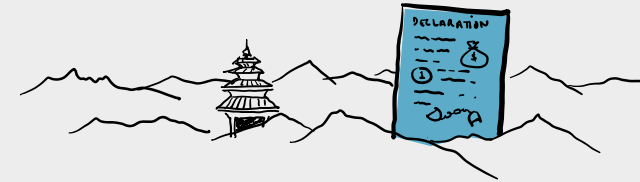
### - The Kathmandu Declaration on Curbing Illicit Financial Flows: Restoring Justice for Human Rights, 2018

The inclusion of the word 'abusive' in the definition draws emphasis on any intended or unintended harm caused in terms of the enjoyment or realisation of different human rights. It is preferable to use the term tax abuse, as it clearly attempts to define the purpose of any tax structure through motivation or primary usage. For example, even if nationally states are able to secure and safeguard their taxing rights through appropriate laws and rules. Multinational corporations (MNCs) and investors use international dispute settlement platforms

to sue governments to reverse a regulation or recover any losses incurred due to compliance measures that have negative implications on investments. In March 2019, 7 UN Independent experts sent a letter to the Working Group III on ISDS Reform highlighting the ISDS mechanism's well-established incompatibility with international human rights law and asymmetrical system that encroaches upon the States' fiscal space<sup>18</sup>. Civil society too for long has advocated against how this characteristically undermines state sovereignty and threatens economic, social and civil rights. Not that all investor disputes will have components of tax abuse, the term still allows us to look at the spirit and impact of the financial flow as much as its legal status in any given jurisdiction.

The Kathmandu Declaration's typology is also a huge step forward in describing the unequal economic and financial relations inherent in the current financial architecture and adequately reflects the evolution of the definition of illicit financial flows over time. It is not only a conceptual synthesis, but also a political recognition of the struggles by civil society and sovereignty-oriented Governments of the South.

Table 2 describes the main recent multilateral (or at least plurilateral) policy shifts or impacts related to the issues listed in the Kathmandu Declaration:



## Table 2: Recent multilateral/plurilateral policy shifts or impacts related to the issues listed in the Kathmandu Declaration

### Tax Abuse

- Profit shifting
- Tax avoidance, tax minimisation
- Tax Evasion
- ⇒ Unitary tax and formulaic apportionment of Transnational Corporations
- ⇒ The Committee of Experts on International Cooperation in Tax Matters, G77 resolution, Organisation for Economic Cooperation and Development (Inclusive Framework on Base Erosion and Profit Shifting), EU Council

### Abusive Tax Incentives

- Race to the bottom practices
- Lowering of corporate income tax rates
- Special Economic Zones, Free Trade Zones
- ⇒ European Commission investigations into illegal state aid
- ⇒ WTO negotiations, International Monetary Fund, World Bank, UNCTAD

### Abusive use of Bilateral or Multilateral Trade Treaties and Investment Agreements

- ⇒ Unilateral big-power security-related trade-restrictive measures, countermeasures and expected loss of the WTO Appellate Body
- ⇒ Reform of the ISDS regime at UNCITRAL and ICSID





### Misuse of Double Tax Treaties

Limited reform of double tax treaties in light of information exchange conventions

### Odious Debt

UN General Assembly resolutions and UNCTAD work on sovereign debt resolution

### Abusive Use of Mutual Arbitration Procedures

Reform of the ISDS regime at UNCITRAL and ICSID

### Trade Misinvoicing

- ⇒ Unitary tax and formulaic apportionment of Transnational Corporations
- ⇒ UNCTAD/ UNECA/ UNESCAP<sup>20</sup>/ UNECLAC/ UNOSSC

### Abusive Transfer Pricing

- ⇒ From arm's length to anticipated reference pricing
- ⇒ The Committee of Experts on International Cooperation in Tax Matters/ OECD/ ATAF/ CIAT

### Illicit Money Transfers

FATF led reforms, including on cryptocurrencies

### Illicit Drug Trade

- ⇒ FATF led reforms
- ⇒ UNODC led reforms



### Harmful Tax Practices

Investigation and regulation of "Big 4" auditing companies

### Unjust Investment Agreements

Reform of the ISDS regime at UNCITRAL and ICSID

### Money Laundering and Terrorism

- ⇒ FATF led reforms
- ⇒ Regional financial intelligence units - Financial Task Force of Latin America (GAFILAT19), Asia Pacific Group on Money Laundering and Eastern and Southern Africa Anti- Money Laundering Group

### Crime

- ⇒ FATF led reforms
- ⇒ UNTOC led reforms

### Bribery

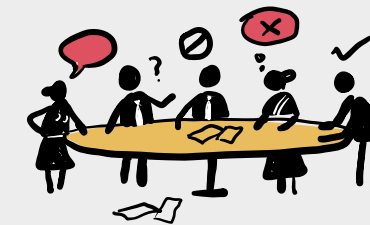
FATF led reforms

### Corruption

- ⇒ UN Office for Drugs and Crime led reforms, Stolen Asset Recovery Initiative
- ⇒ African Union Summit, UNECA

### 'Offshore' Trust Industry

- ⇒ Public registries in UK overseas territories
- ⇒ Global Asset registry proposal



# 4 Building Alliances

The Africa Process—The need for Africa to improve domestic resource mobilisation came at the backdrop of the Millennium Development Goals, and gave rise to an urgency to address the challenge of IFFs emerging from the region. It was in this context that a discussion to sensitise policymakers was initiated at the 4<sup>th</sup> Joint Annual Meetings of the African Union Commission (AUC)/ United Nations Economic Commission for Africa (ECA) Conference of Ministers of Finance, Planning and Economic Development in March 2011.

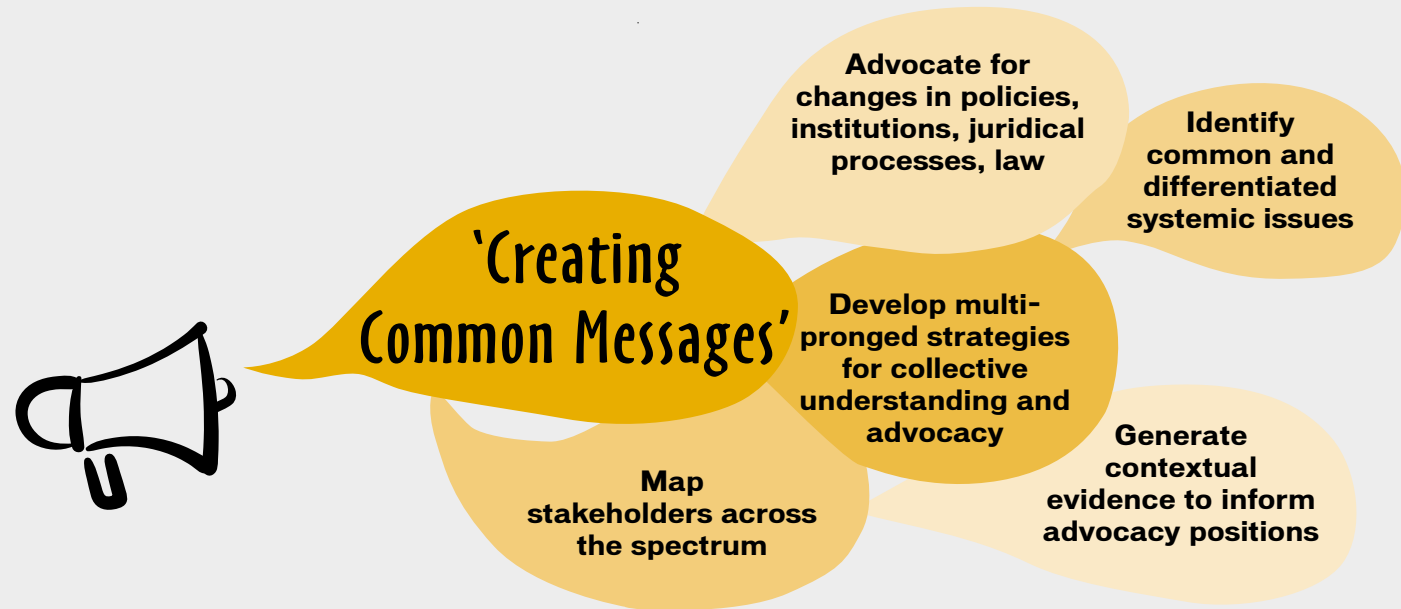
The meeting was attended by representatives from 52 African countries, 20 UN Specialised agencies and 57 observer institutions including Bretton Wood institutions, other institutions from the Global North, International Non-Government Organisations and Africa based regional Non-Government Organisations such as the African Forum and Network on Debt and Development (AFRODAD), Coalition for Dialogue on Africa (CODA), African Capacity Building Foundation (ACBF) among others<sup>21</sup>. After examining the issues at stake, participants called upon the UN Economic Commission for Africa (ECA) and the African Union Commission (AUC) to lead the efforts to combat IFFs from Africa. Consequently, the 4<sup>th</sup> Joint Annual Meetings of the AUC/ ECA Conference of Ministers of Finance, Planning and Economic Development adopted

a resolution mandating the establishment of a High-Level Panel (HLP) on Illicit Financial Flows from Africa and it inaugurated on 5<sup>th</sup> February, 2012 in Johannesburg, South Africa<sup>22</sup>. Following the Resolution of the Ministers, the HLP had the primary role of further exploring and gaining a better understanding of the nature of illicit financial flows out of Africa and assessing its impact on the continent's development. In addition, it was envisaged that the HLP would work to increase collaboration and cooperation amongst African countries, their Regional Economic Communities and external development partners to promote a better global understanding of the scale of the problem for African economies and encourage the adoption of relevant national, regional and global policies, including safeguards and agreements to redress the situation.

#### The specific objectives of the HLP as derived from the Resolution were as follows:

- Determine the nature and patterns of illicit financial outflows;
- Establish the level of illicit financial outflows from Africa;
- Assess the complex and long-term implications of illicit financial flows on development;





- ➔ Sensitise African governments, citizens and international development partners on the scale, and effect of financial outflows on development; and
- ➔ Mobilise support for putting rules and regulations in place at all levels to tackle illicit financial outflows from Africa.

The Panel brought together eminent experts from within and outside Africa who shared

common concerns around financing Africa's development. It was chaired by H.E. Mr. Thabo Mbeki, the former President of South Africa while its Technical Committee was chaired by Dr. Abdalla Hamdok, the Deputy Executive Secretary of ECA. The HLP worked tirelessly with the support of its Technical Committee and through its Secretariat housed within the ECA in Addis Ababa playing an instrumental role in consensus building. The HLP report provided 15 recommendations to curb IFFs from Africa. Countries like Côte d'Ivoire, Ghana, Kenya,

## STOP THE BLEEDING Campaign<sup>25</sup>



**'Stop the Bleeding' IFF Campaign aims to mobilize citizens across Africa towards galvanizing a broad support to tackle IFF including the implementation of HLP report recommendations. The launch at the margin of the Third International Conference on Financing Development was followed by national launches in Zambia, Togo and Nigeria.**

**The Cameroon Executive and Parliament endorsed the Stop the Bleeding campaign, the launch was covered by 5 local news channels depicting a vivid grassroots embrace of the campaign.**

**Ndeye Ndiaye, an alumni of the International Tax Justice Academy, is an active member of Citoyens Actifs pour la Justice Sociale. She collected 40 signatures through the STB website and physical signatures in Senegal. In addition, she attended a conference in Cameroon about governance of extractive industries where she planned to amplify the message on STB to collect more signatures.**





Malawi, Nigeria, Sierra Leone and Tunisia have begun to implement policies on IFFs as per the recommendations of the report<sup>23</sup>.

## Gearing toward actions

Following the endorsement of the High-Level Panel (HLP) Report on Illicit Financial Flows (IFFs) from Africa and the passing of the AU Special Declaration by the African Union Heads of States at the 24<sup>th</sup> African Union Summit in 2015, there was an obvious need to implement its recommendations nationally, regionally and globally. Accordingly, a coalition of Stakeholders which became the Consortium of Stakeholders to Stem IFFs from Africa, was established<sup>24</sup>. Above all else, the Consortium of stakeholders works to foster coherent implementation of the recommendations of the High-Level Panel and ultimately stem the growth of IFFs from Africa. The Consortium further constituted a core group within itself to address all technicalities with regards to implementing the recommendations of the report. This led to the establishment of the anti-IFF Working Group in 2016, which meets annually. The working group constitutes 17 African institutions and several non-African partners who unanimously agreed to maintain and upscale on-going advocacy efforts at regional and global level.

Specifically, the steps agreed upon include strengthening the institutional and regulatory capacity of African countries to combat illicit outflows, increasing advocacy for national and continental policy changes and establishing a multifaceted but united front to address the complex nature of illicit financial flows from the continent. CoDA which has been a key member of the anti-IFF working group and operates as a special initiative of the AUC, UNECA and African Development Bank, directly leading the administrative efforts of the implementation process. Last year, the Secretariat which was originally housed at ECA was moved to AUC to reinforce the monitoring of commitments made by the African Heads of State as per the HLP recommendations.

Simultaneously, the members of the anti-IFF working group have been working to follow-up on and implement the decisions of the Consortium and the Project using their collaborative capacities to do so. This includes the work of CoDA and Trust Africa on the current development of an IFF Knowledge Hub, a centralised source of information aimed at increasing awareness among policy makers and the general public, as well as the co-organization of a Meeting to Converge Civil Society and the Media by both institutions. As of June 2019, the consortium secretariat is committed to developing a

knowledge hub on IFFs and ensuring that the yearly organisation of the Retreats of African Ambassadors to the UN and EU, to be led by AUC, begins from 2019 and involves selected members of the IWG.

## Rising Above IFFs

Illicit money been laundered through shell entities by oligarchs, corporates and the far-right to subvert elections in several countries but also to routinely sway public perception towards anti-minority, xenophobic narratives through the spread of misinformation.

Putting an end to all kinds of illicit finance is an entry point towards reclaiming space in a democracy for

ensuring accountability among state and non-state actors and redistributive politics which enables true public participation and representation. There is a need to go beyond and call out the continued operations of secrecy regimes that act as turntables for financial flows emerging from developing regions. But all of this begins with adopting a progressive and well-rounded definition of illicit financial flows that reflects the impact on human rights in developing countries.

In Table 3 on the next page, we provide a matrix of immediate and long-term approaches civil society actors can follow.

We would strongly recommend going through the other modules to gauge how interventions can be suited to your context.



## Table x: Immediate and long-term approaches civil society actors can follow



### Best Practices

Developing regions apart from Africa have been significantly influenced by the High-Level Panel report.



**Civil society organisations must advocate with UN economic regional bodies and its member states to undertake similar exercises to uncover different sources of illicit financial flows from their region**

Using existing research and scoping on the Global South to build on evidence.



**Civil society organisations, academics and journalists from the Global South can together track national or regional cases on similar economic offenders across borders**

Building awareness through various interventions



**Civil society organisations and journalists can together track national or regional cases on similar economic offenders across borders.**

Establish public registers of ultimate beneficial ownership<sup>26</sup>. Countries like Kenya, Afghanistan, Jamaica have committed to public beneficial ownership registers. Countries like India (at 10%), Peru (at 10%) or Uruguay (at 15%) have gone below the 25% threshold of identifying beneficial owners.



**Civil society across regions must advocate for an openly accessible register on ultimate beneficial owners (true human owners) to challenge all forms of illicit finance.**

Regional tax forums to enable meaningful cooperation and participation on behalf of all countries.



**Asia-Pacific civil society should advocate for a pan Asia-Pacific forum on tax under the auspices of UNESCAP to strengthen regional cooperation, similar to the African Tax Administrators Forum (in Africa) and Inter-American Center for Tax Administrations (in LAC).**

### Action



## Building towards

**Levelling the uneven playing field by challenging the broken international financial system.**

## End Notes

- Rai S. (2017). The Spectre of Illicit Financial Flows: Undermining Justice. Centre for Budget and Governance Accountability. Available at: <http://www.cbgaindia.org/wp-content/uploads/2017/12/The-Spectre-of-Illicit-Financial-Flows-Undermining-Justice-2.pdf>
- Balance of payments are economic transactions of a country that take place in a specified period between that country and the rest of the world. These estimates were compiled by IMF which since 1995 have undergone several revisions.
- Zucman, G. (2015). The Hidden Wealth of Nations: The Scourge of Tax Havens. *University of Chicago Press*.
- Kathmandu Declaration on Curbing Illicit Financial Flows: Restoring Justice for Human Rights (2018). Available at: <https://financialtransparency.org/wp-content/uploads/2018/08/Kathmandu-Declaration.pdf>
- Financial Transparency Coalition (2017). "Who makes the Rules on Illicit Financial Flows?"
- Financial Action Task Force (FATF) is sponsored by the Organisation for Economic Co-operation and Development. UNODC sponsors the Stolen Asset Recovery initiative together with the Washington-based World Bank.
- As of October 2019, the definition and data in the SDG monitoring is yet to be defined, there is no certainty for the definition to come out by 2020 either. Despite demands in the FfD process, to monitor and report back on progress on tackling IFFs by 2020, it too has been unable to come up with a comprehensive definition.
- For example, see the US position on IFFs at the UN (Palazzolo, 2018). Available at: <https://usun.state.gov/remarks/8826>
- A form of profit shifting where the money originating from the South is shifted abroad and "owned" by foreign nationals.
- Aziani, Alberto (2018). Illicit Financial Flows - An Innovative Approach to Estimation.
- Unlike the Multilateral Convention for Administrative Cooperation on Tax Matters, the US has unilaterally directly acquired information from over 14,000 banks and financial institutions on the basis of unilateral legislation known as FATCA.
- The technical module in the IFF Toolkit on 'The Role of Banking in Latin America as a Facilitator of Illicit Financial Flows' discusses the SWIFT messaging system in greater detail.
- Interestingly, the Bank for International Settlements has started to compile payment system statistics in collaboration with SWIFT, and SWIFT itself has put its data analytics business (some of its business intelligence products are Traffic, Scope and Watch that are specifically targeted to regulators) closer to the core of its business.
- Statistics on external debt is jointly developed by the World Bank, IMF and Bank of Settlements.
- Boyce and Ndikumana (2000) in their paper on 'Is Africa a Net Creditor? New Estimates of Capital Flight from Severely Indebted Sub-Saharan African Countries, 1970-1996' observe how private external assets accumulated via capital flight exceed the public external debt, referred to as 'netting'.
- Human Rights Council (2016). Final Study on Illicit Financial Flows, Human Rights and the 2030 Agenda for Sustainable Development of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights.
- Module 4 of this toolkit provides more information on various rights based frameworks that can be used for specific actions.
- OHCHR (2019). UN experts send letter to UNCITRAL Working Group III on ISDS Reform urging systemic changes to the ISDS system. [https://www.ohchr.org/Documents/Issues/Development/IEDebt/OL\\_ARM\\_07.03.19\\_1.2019.pdf](https://www.ohchr.org/Documents/Issues/Development/IEDebt/OL_ARM_07.03.19_1.2019.pdf)
- GAFILAT has not developed a definition on IFFs. Its mandate however, is broad in terms of preventing and combatting money laundering and financing of terrorism.
- For example, the exchange of information between customs agencies of different countries is a part of the Digital Trade Facilitation initiative in Asia and the Pacific led by UNESCAP.
- See here [https://au.int/sites/default/files/documents/30901-doc-com2011\\_proceedings\\_0.pdf](https://au.int/sites/default/files/documents/30901-doc-com2011_proceedings_0.pdf). Eco-

- conomic Commission for Africa, Proceedings from Fourth Joint Meetings. Accessed on 28/06/2019
22. See here: <http://codainaction.org/iff/>
  23. UN Economic and Social Council (2019). Summary of the work of the Economic Commission for Africa, 2018-2019. E/2019/17. [http://www.regionalcommissions.org/ECASummary19\\_issued.pdf](http://www.regionalcommissions.org/ECASummary19_issued.pdf). [Accessed on 15th October, 2019]
  24. The membership of consortium consists of the African Union Commission (AUC), Economic Commission for Africa (ECA), African Capacity Building Foundation (ACBF), United Nations Development Program (UNDP), African Tax Administrations Forum (ATAF), Pan African Lawyers Union (PALU), Tax Justice Network Africa (TJNA), Open Society for West Africa (OSIWA), African Legal Support Facility (ALSF), African Parliamentary Network on Illicit Financial Flows and Tax (APNIFFT), Global Financial Integrity (GFI), World Customs Union (WCO), South Centre, United Nations Interregional Crime and Research Institute.
  25. Building onto the work done by the HLP, the Interim Working Group (IWG) of the African IFF campaign platform comprising six Pan African organisations namely, Tax Justice Network Africa (TJNA), Third World Network Africa (TWN-Af), African Forum and Network on Debt and Development (AFRODAD), The African Women's Development and Communication Network (FEMNET), the African Regional Organisation of the International Trade Union Confederation (ITUC-Africa), and Trust Africa supported and joined by the Global Alliance for Tax Justice launched a unified African campaign on IFFs dubbed "STOP THE BLEEDING" on June 2015 in Nairobi Kenya.
  26. A beneficial owner is a living person, who exercises economic control over an entity either directly or by using legal arrangements (i.e. indirectly) or accrues gains from transactions made under that entity. A public beneficial ownership register containing information on ownership structures and arrangements on all legal entities (companies, trusts, foundations, limited liability partnerships, associations, co-operative societies).

## How to Use the Toolkit?

The toolkit is as an easy and accessible resource for enthusiasts, activists, civil society organisations, practitioners and journalists. Designed in a modular format, the toolkit aims to enable evidence based advocacy from the perspective of developing countries<sup>1</sup> for bringing awareness, policy change, exchanging examples of effective interventions from the Global South and wider collaboration between different actors. Please note that the policy recommendations are aimed to be adapted and tailored across settings, regions and priorities.

All modules are designed independently from each other but are structured in a holistic manner. It is recommended that Module 1 be read first as it sets the premise for this undertaking. The toolkit fulfils three objectives -

- ➔ Provides a well-rounded perspective of illicit financial flows from the Global South context and delving into its regional components.
- ➔ Introduces terms that are set under the framework of human rights, gender justice and the sustainable development agenda with respect to redressing the impact of illicit financial flows.
- ➔ Uses a multi-pronged approach to involve the larger civil society, practitioners and journalists through international and regional mechanisms, simplified case studies to demystify complex topics and examples of successful interventions across the Global South.

The toolkit is available in print and online. The technical module is available in Spanish.

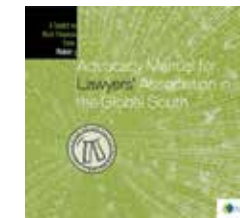
## A Toolkit on Illicit Financial Flows: Perspectives from the South



**Module 1: Politics of Defining IFFs**



**Module 2: IFFs and the Extractives Section in Asia**



**Module 3: Advocacy Manual for Lawyers' Association in the Global South**



**Module 4: Addressing Illicit Financial Flows - National, Regional and Global Interventions**



**Module 5: Technical module: The Role of Banking in Latin America as a facilitator of Illicit Financial Flows**

<sup>1</sup> The toolkit uses the terms developing countries or regions interchangeably with the Global South. The term 'Global South' represents countries in the developing regions of Africa, Asian and Latin America, Central America, Mexico, South America, and the Middle east (with the exception of Israel) that share a colonial and imperial past (with the exception of Japan, Hong Kong, Macau, Singapore, South Korea and Taiwan). Southern countries refer to countries belonging to the Global South.

# About Financial Transparency Coalition

The Financial Transparency Coalition (FTC) is a global civil society network working to curtail illicit financial flows through the promotion of a transparent, accountable and sustainable financial system that works for everyone. For more information, kindly visit: <https://financialtransparency.org/>